information upon which it would have to base its determinations, essentially leaving a prescriptive approach to chance. Indeed, the Commission cannot reasonably expect that it can keep up with the rapidly changing market environment. The Commission, in the NPRM, recognizes that if it misspecifies the prices, competition will suffer.[29] Not only will competition be adversely affected, but also misspecification can chill incentives to invest in the telecommunications infrastructure that are essential to the widespread deployment of advanced telecommunications capabilities.

Nor should the Commission view a prescriptive approach as a backstop to a market-based approach. The Commission inquires whether a prescriptive approach might be used in certain geographic areas or for certain services to ensure that prices move toward economic costs.[30] The Commission presumes that it could identify a set of circumstances that evidence a market failure that could be remedied by the Commission tinkering with rates without having any affect on competition. There are a multitude of factors that influence market outcomes. With the ease of entry and exit into the local market that the Telecommunications Act affords, it is highly unlikely that the Commission could determine with any certainty that a particular price was not a competitive price or that the marketplace was not functioning properly. To the contrary, the specter of Commission intervention is more apt to cause market distortions because competitors'

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29 NPRM at ¶ 143.

30 *Id.* at ¶ 144. The Commission implies that barriers to competition might not be eliminated within a reasonable time which could justify a prescriptive approach as a backstop. The rapidity with which CLECs are entering the local exchange market and interconnection agreements are being approved by the state commissions belie the idea that there are barriers to competition. As long as the Commission holds out to the market that it will intervene, it refocuses competitors' energies from the competitive arena to the regulatory arena.

decisions will be made, if not to influence or affect Commission actions, at least in anticipation of Commission action.

Finally, the Commission questions whether an ILEC's entry into the in-region interLATA market should affect the Commission's choice of a market-based or prescriptive approach for access reform.[31] There is absolutely no reason for ILEC entry into the interLATA market to have any affect on access reform.[32] In an attempt to move the Commission toward a more regulatory mode, some parties have been suggesting that ILECs could engage in a price squeeze once they enter the interLATA market. The alleged problem would stem from a LEC charging IXCs access prices above forward-looking economic costs, while the LEC's long distance affiliate would be able to price its retail long distance services taking into account only the incremental cost the LEC incurs in providing access. Using the lower access cost, the LEC then would be able to charge a lower retail long distance price. IXCs claim they "would be forced either to match the price reduction and absorb profit margin reductions or maintain their prices at existing levels and accept reductions in their market shares."[33]

The allegation that a LEC would harm long distance competition through a price squeeze is completely unfounded given existing statutory requirements and the LEC's incentives. The

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31 *Id.* at ¶ 148.

32 Likewise, the Commission's selection of a market-based or prescriptive approach should have no affect on the Commission's consideration of a BOC's application under Section 271. Section 271 sets forth the check list that the BOC must satisfy in order to provide in-region interLATA service. The Commission's action in this proceeding can neither enlarge nor reduce the check list. On the other hand, satisfaction of the competitive checklist contained in Section 271 for a state should be a sufficient trigger to remove from price cap regulation all access services provided within the state.

33 NPRM at ¶ 47.

supposed conundrum an IXC would face in deciding whether to accept reduced profit margins or reduced market share is nothing more than a reflection of the fact that, if LEC affiliates start to provide long distance service, their entry will likely lead to downward pressure on long distance prices. This is procompetitive and benefits consumers.

As long as a LEC long distance affiliate prices long distance service at or above the sum of the access price level plus the additional incremental costs the LEC affiliate incurs providing long distance service, there is no legitimate complaint about the LEC's pricing, and there is no price squeeze. A price squeeze involves the situation where a supplier of an input that is essential for competitors to purchase prices the input and its own (competing) retail service at levels that would cause an equally efficient competitor to exit the market. Because, by definition, the LEC long distance company is covering all its incremental costs if it charges a retail price at or above the sum of the price it pays its affiliate for access, plus the additional incremental costs of providing long distance, it would not exit the market, nor would an equally efficient competitor. As the Supreme Court noted in Brooke Group. v. Brown & Williamson, "above-cost prices that are below general market levels or the cost of a firm's competitors" are not considered anticompetitive under the antitrust laws.[34] The Brooke Group Court also noted that "[a]s a general rule, the exclusionary effect of prices above a relevant measure of cost either reflects the lower cost structure of the alleged predator, and so represents competition on the merits, or is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price-cutting."[35]

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34 509 U.S. 209, 223 (1993).

35 *Id.* at 223.

Existing statutory requirements prohibit the sort of pricing IXCs claim could be anticompetitive. Section 272(e)(3) requires the LEC long distance affiliate to purchase (or the LEC to impute to itself if it is providing long distance service) access at rates no lower than those rates offered to others, and Sections 201 and 202 prohibit the LEC or LEC long distance affiliate from pricing below incremental cost.[36] In addition to being prohibited, the type of pricing the IXCs fear would be easily detected, since access prices are known, and LEC long distance affiliates are subject to extensive biannual audits.[37]

Finally, it is highly unlikely that LECs would have any incentive to price long distance service below the sum of access prices and the other incremental costs of providing service because it would be making less per minute of long distance sales than per minute of access sales. Each minute of long distance a LEC long distance affiliate sells directly to a customer is likely to displace a minute of LEC access sales. Thus, the opportunity cost of selling long distance rather than access is likely to exceed the long distance profits if the LEC prices long distance below this point.

Further, there should be no question that a LEC has no realistic chance of forcing long distance capacity from the market and subsequently being able to recoup any loss suffered while engaging in the price squeeze. In any event, the IXCs' ability to buy unbundled network elements at cost-based prices to provide their own access to customers for whom they are the local service provider would provide an additional check on the ability of a LEC to engage in an

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[36] *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, released December 24, 1996, at ¶ 258.

[37] 47 U.S.C. § 272(d).

anticompetitive price squeeze. In fact, the IXC would get "access" to these customers at no additional cost. This would place the IXC at a pricing advantage vis-á-vis the LEC long distance affiliate.

B. The Goal--Deregulation In The Presence Of Substantial Competition

1. Objectives (Paras. 149-155)

Access reform should, among other things, result in increased competition for exchange access services. As competition develops, the need for regulatory oversight diminishes. Indeed, continued regulatory intervention can have anti-competitive effects. Such regulation, rather than promoting competition, would instead promote the interests of competitors. A market-based approach to access reform would establish trigger points wherein certain Commission rules would be relaxed or cease to apply. In essence, the Commission's regulation is metered to the level of competition. The triggers in a market-based approach are self-implementing.

As the competitive marketplace continues to develop, the point will be reached that further Commission regulation is unnecessary. The Telecommunications Act provides that the Commission shall forebear from applying a Commission rule or regulation in whole or in part that is not necessary to ensure that: (1) charges or practices of a carrier are just and reasonable; (2) the charges or services are not unreasonably discriminatory; and (3) consumers are protected.[38] In making its forbearance determinations, the Commission is directed to consider whether forbearance of its regulations will promote competition among providers of telecommunications services.[39] Thus, under the statutory scheme, the presence of substantial competition requires the

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[38] 47 U.S.C. § 160.

[39] 47 U.S.C. § 160(b).

Commission to forebear from enforcing regulations that would otherwise interfere with the continued growth of competition.

Forbearance need not occur at the same time for all services or in all geographic areas. The statute authorizes the Commission to forebear from applying its rules and regulations by service and by geographic area.[40] Under the forbearance provision of the Telecommunications Act, the carrier may petition the Commission for relief. Given the completeness of the statutory process, the Commission need not, in this proceeding, attempt to prejudge the showings or geographic areas that would satisfy the statutory criteria for forbearance.

As the Commission recognizes, competition among services may vary by geographic area.[41] The most reasonable expectation at this time is that competition will develop in groups or clusters of exchanges ("exchange groups"). Pragmatically, exchange groups will not likely impose significant administrative burdens on the Commission in fulfilling its statutory requirements. Certainly, the Commission could indicate a preference that petitions for forbearance be based on the exchange group concept, but in order to be consistent with the statute, the Commission will have to allow for variation that may occur among ILECs or within a particular LEC's operating territory.[42]

As an initial step toward deregulation, the Commission asks whether the Commission should remove high capacity special access services from price cap regulation.[43] There can be

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40 47 U.S. C. § 160(a).

41 NPRM at ¶ 155.

42 In Section III.B.2., BellSouth addresses the factors to be considered in addressing the competitiveness of the marketplace.

43 NPRM at ¶ 153.

little doubt price cap regulation is no longer necessary for all high capacity transport services. The distinction between special access transport and switched access transport represents an artificial regulatory distinctions that have no validity in the marketplace. The simple fact of the matter is that the transport capabilities of competitive access providers are a substitute for an ILEC's switched and special transport. Likewise, the unbundled transport network elements that are available to telecommunications carriers are not limited regarding the type of traffic that can be transmitted over such network elements. Thus, for the Commission to continue to perpetuate the specious distinction between special and switched transport requires the Commission and the carriers to engage in an analytical charade.

In connection with its comments in the *Price Cap Performance Review for Local Exchange Carriers*, BellSouth submitted data and analyses demonstrating the widespread deployment of facility networks of competitive access providers.[44] Thus, nearly three years ago, BellSouth demonstrated that it faced substantial facilities-based competition for transport services in its major markets. BellSouth also demonstrated that future entry could be targeted to a limited number of wire centers wherein access and business revenues are concentrated.[45] Hence, the expansion of facilities-based competition could easily be accomplished. Those data alone are

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44 *In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket 94-1,* Comments of BellSouth Telecommunications Inc., May 9, 1994. These comments are incorporated by reference.

45 BellSouth prepared an empirical analysis that showed that revenues are concentrated in densely populated areas and business districts of metropolitan areas. For example, across the BellSouth region, the top 1% of business customer locations account for approximately ⅓ of BellSouth's business revenue. *See* Attachment 2 to BellSouth Telecommunication's Inc.'s May 9, 1994 Comments in CC Docket 94-1.

sufficient to demonstrate substantial competition for transport in the major metropolitan areas for BellSouth.

Since that study was submitted to the Commission, facilities-based competition has indeed expanded. With this filing, BellSouth is submitting additional and current data showing the widespread deployment of alternative access networks.[46] As these data show, by the end of 1996, there were a total of 94 alternative networks in operation serving 50 different cities in BellSouth's operating territory. The most significant growth of alternative networks took place in Tier II and Tier III markets due to the expansion of regional competitive access providers ("CAPs") such as Brooks Fiber Properties, American Communications Services Inc. and the IntelCom Group.

These competitive networks have capabilities beyond the mere transport of telecommunications service. At present, 40 CAP networks are equipped with switching capability and 34 more are scheduled to provide switched services during 1997.

With the availability of unbundled network elements, expansion of competitive networks is instantaneous and geographically unlimited. Thus, competitors not only can fill out their networks, but enter into new geographic areas without undertaking any investment risk. Thus, there are no barriers to entry or exit that remain for transport services. In these circumstances, the LECs do not have market power over price for any transport services. Any attempt by an ILEC to raise the price of a high capacity service above the competitive level is unsustainable. A LEC competitor can easily undercut such a price by obtaining unbundled network elements and providing transport services to the LEC's customers. In these circumstances, there is no reason for high capacity services to be subject to price cap regulation.

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[46] *See* Attachment 1.

Contrary to the implication in the NPRM, removing a service from price cap regulation does not require significant modification of the price cap rules or detailed procedures with regard to the recalculation of price cap indices.[47] The Actual Price Indices (APIs) are calculated using the demand and rates for services that are subject to price cap regulation.[48] From one annual period (referred to as the base period under the price cap rules) to the next, the relevant APIs are only adjusted to reflect rate changes. Demand adjustments are only made once a year when the new base period is used to calculate the APIs. Accordingly, if a service were removed from price cap regulation, then, at the next annual period, that service's demand would simply be excluded from the calculation of the relevant actual price indices and subindices. In effect, the calculation is no different (nor should it be) than that done today to the extent services are excluded from price caps.

2. Competitive Factors (Paras. 156-160)

In the NPRM, the Commission enumerates several factors that could be considered in measuring the competitiveness of the market for particular services.[49] Three of the factors, demand responsiveness, supply responsiveness and market share, are the same criteria the Commission considered for streamlining AT&T's interstate services. There the Commission recognized that these factors do not all carry the same weight. Market characteristics for different services warranted different points of emphasis.

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47 *See* NPRM at ¶ 154.

48 Certain services provided by the LECs were specifically excluded from price cap regulation, such as individual case basis rates, presubscription services, and packet switching service.

49 NPRM at ¶¶ 156-160.

For example, the overarching criterion for granting streamlined regulation to AT&T's business services was the supply elasticity of those services. The demand responsiveness of business services was inferred from the type of users that purchase business services. These users "tend to be more informed and sophisticated purchasers of telecommunications services than other customers" and increasingly exercise their "buyer power" by soliciting competitive bids before procuring telecommunications services.[50]

There is a clear parallel between AT&T's business service market and the market of interstate access services. Like AT&T's business service market, the customer base for interstate exchange access is well informed. Indeed, access customers are by far the most sophisticated and technically knowledgeable group that exists in the telecommunications marketplace. The majority of interstate access is obtained by common carriers, some of whom are actual competitors of the ILECs and all of whom are potential competitors. Non-carrier customers are generally large telecommunications users who share the characteristics of business users in the interexchange market.

There can be little question that exchange access customers are aware of the choices and alternatives that are available as well as the dynamics of the exchange access marketplace. Historically, interexchange carriers have shown their demand responsiveness. From the inception of access charges, interexchange carriers have taken advantage of every opportunity to reduce the prices they pay for access facilities. Every change in a Commission rule that altered the relative price relationships between switched and special access has brought with it a corresponding

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50 *Competition in the Interexchange Marketplace*, 6 FCC Rcd 5880, 5887 (1991).

change in demand for access services. Illustrative of this behavior is the development by interexchange carriers of Megacom-type and 800 Readyline-type offerings.

With the enactment of the Telecommunications Act, the opportunities for interexchange carriers to substitute alternatives for ILEC exchange access services increase exponentially. Given the historical behavior of these customers to minimize their access costs, there can be no doubt that these customers will evaluate the full range of options available and will exercise the least cost option. Thus, demand responsiveness clearly can be inferred for exchange access services. There is no need to make a separate demonstration of this factor in order to determine the competitiveness of the exchange access marketplace.

The key criterion for evaluating competition for exchange access is elasticity of supply. The more elastic the prevailing conditions of supply, the less possible it is for ILECs to raise prices and limit output. Where a market segment is characterized by a high elasticity of supply, even small price increases will elicit large expansions of output.

Elasticity of supply is determined by a variety of factors, although two predominate. The first is the supply capacity of existing competitors. If competitors have or can acquire significant additional capacity, then supply elasticities tend to be high. Even if existing competitors do not have substantial excess capacity, another factor, conditions of entry, can establish that a market segment is characterized by high supply elasticity. If economic and non-economic barriers to entry are removed, a fair opportunity for self-policing competition is created.

When presented with a petition for forbearance, it is clear that the most meaningful measure of the competitiveness of the exchange access market will be the supply elasticity. Interexchange carriers, by their call here for price reductions in exchange access, demonstrate they are price responsive, and are prepared to seek out the lowest price access alternative. Thus, to the extent that the Commission finds a high elasticity of supply, such a finding would be sufficient to establish that the service is subject to substantial competition. The immediately available supply capacity acts to constrain the ILEC's market behavior and precludes the ILECs from charging excessive rates. Clearly, the Commission can find here that the ready availability of unbundled network elements at cost-based rates, as required by the Telecommunications Act, is conclusive evidence of a high supply elasticity in the access market.

Market share is not a criterion that should be used for assessing the competitiveness of the marketplace. In its comments to the Second Further Notice of Proposed Rulemaking in CC Docket 94-1, BellSouth attached a statement by Dr. Jerry Hausman who addressed the use of market share as a criterion for streamlining regulation.[51] In his statement Dr. Hausman stated:

> Market share is an incorrect measure of competitive conditions. High market shares do not denote market power, especially given the supply and demand conditions in telecommunications....
>
> The most important competitive factor to realize in judging potential market power is that competition takes place at the margin. It is this principle of economics that market share calculations miss. For instance, if BellSouth were to attempt to keep its price 5% above the competition, it would only need to lose about 7% of its traffic for this price difference to be unprofitable, given the low marginal costs of most telecommunications services...Thus, competition at the margin, not market share, is the primary economic factor which determines prices.[52]

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[51] Comments of BellSouth Telecommunications Inc. on the Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, filed on December 11, 1995 and incorporated herein by reference.

[52] Comments of BellSouth Telecommunications Inc. submitted on December 11, 1995, Statement of Dr. Jerry Hausman, pp. 24-25.

Dr. Hausman's admonition against the use of market share as a competitive factor continues to be applicable. Further, the Commission has not attributed importance to market share where there are high elasticities of demand and supply.[53] Certainly, there is nothing in the exchange access market that would justify the Commission to ascribe a greater weight to market share than it did in similar circumstances for interexchange services.

Another factor the Commission suggests may be useful in determining the competitiveness of the access market is the degree to which the ILEC prices below the cap.[54] The Commission, in the NPRM, recognizes that below cap pricing or the failure to price below cap is not necessarily indicative of competitive conditions. Given the myriad of factors that enter into competitive pricing decisions, the Commission would have to engage in substantial and in depth analysis before it could conclude that a particular pricing pattern evidenced a particular competitive level. The analysis would inevitably turn to an evaluation of supply elasticity. Hence, it is not pricing relative to the cap that will indicate the competitiveness of the market, but rather supply responsiveness.

IV. MARKET-BASED APPROACH TO ACCESS REFORM

As these comments have thus far demonstrated, a market-based approach to access reform is the approach that is most consistent with the Commission's objective of establishing a fully competitive market for exchange access and, indeed, the only approach that makes the objective achievable. A market-based approach is premised on the concept that regulation should be adjusted to reflect the development of competitive conditions. As market conditions operate as a

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53 *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd at 5889-90.

54 NPRM at ¶ 159.

sufficient check on a regulated carrier's conduct and performance, then regulation should give way to market forces and let the market function unencumbered by the regulatory process.

Between the current degree of regulation of ILECs and forbearance, there are intermediate steps that can be taken by the Commission that will conform the regulatory process to the level of competition. The task here is to identify the competitive triggers that would signal a reduced reliance on Commission economic regulations and to specify the proper regulatory paradigm associated with the competitive triggers.

As a general matter, BellSouth supports a two-phased approach, such as that suggested in the NPRM, to defining the intermediate regulatory steps leading to forbearance. BellSouth, however, departs from the Commission's specific proposals. Below, BellSouth sets forth its proposals for a two phase market-based approach to access reform.

A. Phase I (Paras. 168-201)

BellSouth's proposal builds upon the fact that supply responsiveness is the key to measuring competitiveness of local and exchange access markets. BellSouth believes that Phase I should be based on a competitive trigger that shows that the ILEC has taken steps to open its markets to competition. BellSouth has submitted evidence in the LEC price cap performance review and in this proceeding that shows the rapidity with which backbone networks are being deployed. While these networks alone might initially be viewed to afford substantial competition for only segments of interstate access, with little modification or addition, these networks are easily substitutable for ILEC local networks and the full panoply of services provided by the ILEC.

To recognize this potential, BellSouth proposes as a competitive trigger for Phase I regulatory relaxation, the existence of a negotiated or arbitrated interconnection agreement approved by the state as called for under Sections 251 and 252 of the Telecommunications Act.[55] The competitive trigger would apply separately for each state within which an ILEC provides local exchange service.

An approved interconnection agreement together with the other requirements of Section 251, i.e., resale, reciprocal compensation, number portability, dialing parity, access to rights of way and conduit, unbundled access to network elements, collocation as well as Section 252's continuing obligation on ILECs to negotiate further agreements, clearly set the stage for robust competition. Accordingly, it is at this point that the Commission should make improvements to its regulations that make them more efficient, less restrictive and permit ILECs to operate more like its competitors.

A distinction between BellSouth's proposed competitive trigger and that of the Commission is that the trigger must be consistent with Sections 251 and 252 which requires that the Commission rely on the implementation of those Sections by the appropriate state commissions. While the Commission's proposed competitive triggers appear to use the requirements of these Sections, the Commission goes beyond the statute's requirements and proposes to include, as part of the trigger, specific implementation requirements. Such implementation requirements are clearly inappropriate. The state commissions have the primary

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[55] 47 U.S.C. §§ 251 and 252. Section 252 permits an a Bell operating company to file a statement of generally available terms subject to the approval of a state commission. 47 U.S.C. § 252(f). Such statement must comply with Section 251 in order to be approved by the state commission. 47 U.S.C. 252(f)(2). Accordingly, the approval of such a statement by a state commission would be sufficient to trigger Phase I regulatory relief.

responsibility of determining compliance with Section 251 and 252 including the price for unbundled elements and the discount for resold services. If the Commission were to attempt to substitute its determinations for those of the state, the Commission would effectively establish a competitive trigger that is unattainable and would make the market-based approach a sham.

Establishing a reasonable competitive trigger, that is identifiable, measurable and achievable and that results in a measured and corresponding reduction in regulation, is in the public interest. Consumers will benefit through a wider range of service choices and reduced rates, all of which translates to a more efficient market. It is for this reason that the Commission should adopt BellSouth's competitive trigger for Phase I.

Associated with the competitive trigger would be specific modifications to the Commission's Part 61 and Part 69 rules that would permit ILECs to conduct their businesses in a more competitive manner in recognition of the fact that detailed regulation is not needed to limit ILEC market conduct because the marketplace can adequately constrain LEC behavior.

The Commission has proposed four basic modifications to its rules if the ILEC demonstrates it has satisfied the competitive trigger for Phase I: (1) elimination of the prohibition against geographic deaveraging within a study area; (2) elimination of the ban on volume and term discounts; (3) permitting contract carriage and individual request for proposals; and (4) the deregulation of new access services.[56] The direction of the Commission's proposals is correct. In some cases, however, they miss the mark. Before discussing these proposals and BellSouth's suggested modifications, there is another regulatory adjustment that is warranted, modification of the LEC price cap basket structure. BellSouth's proposed price cap structure is intended to

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[56] NPRM at ¶ 168.

improve the efficiency of the LEC price cap rules and to better align the plan as a transition mechanism to competition. BellSouth would replace the current five basket structure with a single Network Services basket. Associated with this price cap basket would be nine service categories: (1) common line including carrier common line and end user common line; (2) local switching; (3) information; (4) database services; (5) dedicated transport; (6) transport interconnection charge (TIC); (7) tandem switching and transport; (8) interexchange services; and (9) video dialtone services. The common line and TIC categories would have no upward pricing flexibility. The remaining access service categories would all have a maximum 10 percent upper pricing limit. Interexchange and video dialtone service categories would not have upper limit pricing bands but rather would be constrained by the overall network services basket price cap.[57]

As one of its regulatory modifications, the Commission proposes to permit geographic rate deaveraging of all access services except subscriber line charges. BellSouth supports the deaveraging of all access charges including subscriber line charges. BellSouth believes that the efficacy of zone pricing has already been established for transport services and clearly should be extended to other access service categories. For each service category, each zone would have an upper pricing limit of 10 percent.

The Commission solicits comments on whether there is a relationship between geographic deaveraging of access charges and Section 254(g) of the Telecommunications Act which requires average nationwide toll rates. History has shown that access charges can be deaveraged without affecting average interstate toll rates. When the access charge rules were first promulgated, all LECs were required to participate in the carrier common line pool and charge a uniform,

[57] BellSouth's modified price cap basket structure is illustrated in Attachment 4.

nationwide carrier common line rate. Subsequently, with consideration of implementing subscriber line charges, the Commission also considered permitting LECs to withdraw from the mandatory carrier common line pool. At that time, one of the arguments against permitting LECs to withdraw from the mandatory pool was that such withdrawal would mean that interexchange carriers would face deaveraged carrier common line charges and that such deaveraging would lead interexchange carriers to deaverage interstate toll rates.

Eventually, after much hand wringing, mandatory pooling was eliminated, carrier common line rates were deaveraged, but interstate toll rates remained averaged. There were no adverse consequences associated with the end of mandatory pooling and there is no reason to believe that zone pricing of carrier common line charges should have any adverse impact on an interexchange carriers offering of averaged toll rates consistent with Section 254(g).

Conceptually, BellSouth agrees that any limitation on volume and term discounts, to the extent that they continue to exist, should be eliminated in Phase I. BellSouth disagrees with the Commission's characterization that any offering of a switched transport service above a single DS3 is a volume discount. The fact of the matter is that transport services are available in capacities of multiple DS3s. These services are based on different types of equipment such as OC3 and OC48 systems each of which has significantly different costs. To characterize an OC3 or an OC48 as a volume discount of a single DS3 is like suggesting that a single DS3 is a volume discount of a voice grade circuit.

The current Part 69 rules that prevent ILECs from offering these distinct high capacity services impose an inefficient pricing structure that is contrary to the public interest and the development of a competitive access market. This regulatory inefficiency artificially inflates switched transport prices and causes access customers to pay higher transport charges than would otherwise be the case.

The Commission acknowledges that its current limitations result in inefficient rate structures.[58] It is preposterous to consider that such an acknowledged inefficient rule should be kept in place until some level of competition is demonstrated. Repeatedly in the NPRM, the Commission states that inefficient rules are not the basis upon which a competitive market can be established. Such rules send the wrong market signals to competitors, either causing inefficient entry or deterring efficient entry.

The Commission should, as part of the baseline changes proposed by BellSouth, permit multiple DS3 services to be offered for switched transport. The remaining prohibitions on volume and term pricing would be removed in Phase I. Volume and term pricing are standard commercial arrangements. Such pricing has long been permitted for special access services and the limitations that are in place today can be related to the Commission's use of access services to manage interexchange competition. In the past, the Commission has been concerned that because of its size and dominant position in the interexchange market, AT&T would disproportionately benefit from volume and term pricing. Such concerns are clearly no longer valid. Having declared AT&T to be a nondominant carrier, the Commission can have no concern regarding the impact of volume and term pricing on interexchange competition.

Accordingly, while removal of all limitations on volume and term pricing would be justified as a baseline change, certainly, this artificial pricing constraint cannot survive beyond Phase I of a market-based access reform approach. The Commission cannot lose sight of the fact

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[58] NPRM at ¶190.

that Phase I is an intermediate step on the path that leads toward an efficient, competitive market. If the Commission fails to remove this artificial constraint, the effect would be to command ILECs to charge inefficient access rates which in turn would distort competition in the markets for exchange access.

The Commission also proposes to permit contract carriage including competitive response tariffs and tariffs in response to RFPs. Permitting contract carriage would constitute a significant pro-competitive step. Providing services pursuant to contract is a well-established way of doing business within the telecommunications industry, and, indeed, is expected by sophisticated customers that frequently wish to negotiate the formulation of the service proposal. A "one-size-fits-all" generic tariff offering falls short in meeting the diverse demands of customers. To the extent that the Commission's rules continue to prevent LECs from providing contract carriage services, the rules confer a substantial, but non-economic based, advantage to LEC competitors.

The extension of contract carriage to the ILECs carries with it multiple benefits. Contract carriage provides, for example, a means for all customers of access services to have services developed that are tailored to their specific needs and requirements. Without contract carriage, LECs are forced to make choices as to what variables can be incorporated into general offerings. The end result is often a service that is adequate for a few and satisfies no one. Contract carriage, on the other hand, is a means of satisfying a broad spectrum of needs, so that every customer--ranging from individual small businesses to AT&T--can expect that its service requirements will be met.

Further, contract carriage will benefit competition in that it will stimulate the price and service rivalry that the Commission expects competition to engender. As customers put their contracts for telecommunications services out for bid, the participation of the LECs will make the bidding process more competitive, expand customers' choices and increase customer buying power in the access market. All of these lead to reduced prices for exchange access.

Further, contract carriage can increase network efficiency and lower network costs. The current requirements that all LEC access services be general tariff offerings can entail network deployments that may not be consistent with or justified by market demand. Contract carriage enables LECs to make more rational network deployments that are based on specific and actual customer demand. Such allocative efficiencies inure to the benefit of all customers.

Contract tariffs would contain general terms of the offering and be filed with the Commission. Thus, any similarly situated customer could request a comparable arrangement which would assure that there would be no unreasonable discrimination.

The Commission proposes to exclude contract carriage services from the calculation of price cap indices. The Commission believes that its proposal would ensure that contract carriage is not used to obtain upward pricing flexibility for generally available services. While BellSouth believes that the Commission's concern is not well founded, BellSouth would not object to excluding contract carriage services from price caps.

In addition to contract carriage, another innovative approach that should be permitted under Phase I is billing end users directly originating switched access charges. Such a step would be market focused and allow end users to negotiate and receive switched access services that are designed to take into account their specific needs.

The final Phase I regulatory reform proposed by the Commission is the deregulation of new services.[59] Implementation of this proposal would be a bold, pro-competitive step. Objectively, no rational argument can be mounted that justifies the Commission requiring an ILEC to obtain regulatory approval prior to filing a tariff for a new service. Indeed, irrespective of whether the Commission determines to deregulate new service offerings, the Commission must make a baseline change to the Part 69 rules that would do away with the regulatory obstacles to carrier-initiated new service filings.

Any rate structure specified in the Part 69 rules should be nothing more than the elements the Commission believes LECs should continue to make available to access customers until circumstances justify relieving a LEC from application of the Part 69 rules.[60] In other words, the rate structure rules should not preclude the filing of new or restructured services so long as the LEC continues to offer the structure identified in Part 69. Indeed, failure to adopt such a baseline approach would put the Part 69 rules in direct conflict with the amendments to Section 204 made by the Telecommunications Act. The statutory revisions, which take effect on February 8, 1997, create a streamlined regulatory framework that applies to <u>all</u> tariff filings made by a LEC. The Commission cannot establish a rule that is inconsistent with or contrary to the express provisions of the Communications Act.

Notwithstanding the impact of the Telecommunications Act on LEC new service filings, there is no need for the Commission to continue to regulate new services. The core access

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[59] NPRM at ¶¶ 197-200. As used by the Commission, the term deregulation means removing new services from price caps.

[60] As discussed in Section IV.B., *infra,* Phase II of the market-based approach should eliminate the application of Part 69 to ILECs.

services will remain available. Deregulation of new services will provide incentives to ILECs to develop new capabilities, because the possibility that the regulatory process will be used to delay or obstruct new service introduction will be eliminated.

As the Commission observes, there are sufficient safeguards in place that would preclude an ILEC from discriminating in favor of its affiliates.[61] The deregulation of new services does not mean that the Commission must relieve the ILEC of its obligation to conduct itself in a nondiscriminatory fashion as required by Section 202 of the Communications Act. Further, Section 272(e)(3) requires that it charge to its affiliate or impute to itself an amount for access to its telephone exchange service that is no less than that charged to any unaffiliated interexchange carrier.[62] With these safeguards in place, the potential benefits of deregulation identified by the Commission,[63] increased customer choice, streamlined regulation, and increased consumer welfare due to increased incentives for innovation, have no counterweight.

The Commission also questions whether, if it deregulates new services, it should extend such treatment to all services that LECs were required to obtain a Part 69 waiver prior to their implementation. If the Commission removes new services from price cap regulation and wants to consider removing other services from price cap regulation, then the appropriate mechanism is for the Commission to forebear from applying price cap regulation to such services in accordance with Section 160 of the Communications Act.[64]

B. Phase II (Paras. 201-217)

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61 NPRM at ¶ 198.

62 47 U.S.C. § 272(e)(3).

63 NPRM at ¶ 197.

64 47 U.S.C. § 160.

BellSouth agrees with the Commission that Phase II should result in further relaxation of regulation. Most of the reforms being considered by the Commission as Phase II adjustments, however, should in fact be made either as part of baseline or Phase I changes. The regulatory changes must be commensurate with the competitive environment. The competitive trigger for Phase II should build upon the Phase I trigger. Where the Phase I trigger would be based upon the existence of interconnection agreements, the Phase II trigger would be based on the actual implementation of the agreement. In other words, the Phase II trigger would require competitive carriers to be providing local services in competition with the ILEC pursuant to these agreements.

Recognizing that actual competition will take place in areas less than the full operating territory of the ILEC, the competitive trigger should apply by exchange or group of exchanges. As a threshold matter, the ILEC would identify the geographic area to which the competitive trigger would apply. The ILEC would also demonstrate that competitive carriers are in fact providing competitive services.

Once the ILEC establishes that it has satisfied the competitive trigger, then for the specific geographic area, the services within that geographic area will no longer be subject to price cap regulation or the core rate structure requirements of the modified Part 69 rules. By fulfilling the requirements of the competitive trigger, the market is sufficiently competitive to provide an effective competitive check on the prices ILECs establish for their services. Any attempt by the ILEC to establish rates above the competitive level will either spur new entry or a competitive response by existing competitors. At this point, ILECs cannot be considered as having the market power to raise prices or restrict output.

Under Phase II of the market-based approach, ILECs would still be required to file tariffs. Such tariffs, of course, would be subject to the streamlined provisions of Section 204(a)(3).[65] The Commission should amend its Part 61 rules, however, to eliminate the requirement for filing cost support with any tariff filing made under Phase II requirements. The Commission should also make clear that any party that seeks suspension and investigation of a filing made by an ILEC under Phase II rules bears the burden that petitioners currently bear for filings made by nondominant carriers.[66]

Under Phase II, the Commission would continue to have oversight regulatory responsibilities. The Commission's economic regulations, however, would give way to market forces in recognition of the fact that the market is more likely to establish a set of efficient prices and that Commission interference could distort and chill emerging competition.

V. THERE IS NO LEGAL OR POLICY JUSTIFICATION FOR THE COMMISSION TO ADOPT A PRESCRIPTIVE APPROACH TO ACCESS CHARGE REFORM

As set forth above, BellSouth strongly believes that carriers, consumers and the public interest will be best served by an approach to access charge reform that permits market forces, rather than regulation, to determine how quickly access prices will move to cost-based levels. In 1990, when the Commission moved from rate-of-return regulation to an incentive-based system of price regulation, the Commission recognized that direct regulatory intrusion and manipulation of the marketplace "did not serve to sharpen the competitiveness" of the local exchange carrier

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65 47 U.S.C § 204(a)(3). Under this provision LEC tariff filings shall take effect in 7 days for a rate decrease and 15 days for a rate increase and shall be deemed lawful unless the Commission acts to suspend and investigate.

66 *See* 47 C.F.R. § 1.773(a)(1)(ii).